

Multistate Tax Commission
Meeting of Taskforce A, Corporate Tax Public Participation Working Group
Reporter's Notes
June 18, 1997
Fairmont Hotel, Dallas, TX

At the conclusion of the morning session of the meeting of the Public Participation Working Group on the Definition of a Unitary Business and Business/Non-Business Income, various taskforces were formed to deal with specific unresolved issues in the draft proposals for changes in the 1973 regulations. Taskforce A selected two topics, designated Topic #2 and Topic #6.

Topic #2: The definition/test(s) for business and from non-business income.

Topic #6: The application of the unitary business principle definition to diverse businesses.

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Discussion of Topic #2

The members of the taskforce had a general discussion of the issues that arise in distinguishing business income from non-business income. The members initially discussed whether the focus should be on the UDITPA statute or on the general policy of treating business and non-business income differently. There was a tentative consensus for focussing initially on policy issues.

One member suggested that the appropriate starting point in defining non-business income should be to determine what is the business of the taxpayer. Once that business has been identified, it should not be difficult to determine what income is unrelated to that business. One member suggested that the "business" of a taxpayer is the set of activities that generate the products sold to some public or sold in some market. After discussion, several members concluded that the problem of identifying the taxpayer's business might be just as difficult as identifying non-business income directly.

Some members noted that the term "non-business" income is not fully descriptive of the concept that the draft regulations are attempting to describe. It was suggested that the basic goal of the regulations is to identify income that cannot be apportioned because it does not have sufficient nexus to all of the taxing states in which the unitary business is being conducted. This line of reasoning would suggest that "business" income should be defined in terms of the constitutional limitations imposed by the Court. Some members suggested that the draft regulations come close to that result. That is, they tax all income as business income to the extent permitted by the Court.

A consensus began to emerge that changing the terminology used to describe non-business income would not be very helpful, notwithstanding the inexactness of the current terminology. At least for now, the members agreed to use the draft regulations as the starting point for their discussions.

The suggestion was made that all income should be treated as business income unless the taxpayer established that a particular category of income arose from activities conducted with a clear investment purpose. Under this approach, an activity would not have an investment purpose if the objective was to save up to acquire a business asset. Objection was made that an approach that focussed on the future use of income might be inconsistent with *Allied-Signal*.

Some members suggested that the current regulation, although consistent with constitutional restraints imposed by the Court, is not consistent with the UDITPA statute. Some discussion ensued as to whether the taskforce was authorized to recommend an amendment of the statute and whether such a proposal would have any practical implications. The taskforce was informed by the MTC staff that a recommendation for a modification in the statute would be entirely appropriate if the taskforce concluded that amendment of UDITPA was needed to have a proper regulation. Some discussion ensued on the steps for achieving an amendment in Compact states and other UDITPA states. Some members suggested that an amendment of the UDITPA statute would not be required as a practical matter because many states have interpreted it to allow for both tests and that in the states where the courts have held otherwise, a statutory fix has already been adopted.

Some members noted that a double taxation problem arises when a state treats income as allocable income (rather than apportionable income) contrary to the general practices of the Compact states. There was a concern that nothing done by the MTC could eliminate such a result.

A suggestion was floated that those who believed that the current UDITPA statute was inconsistent with the draft regulations might prepare some written comments on that point prior to the first teleconference. The response was that the comments prepared by Peter Faber make that point.

A consensus emerged that the initial focus of the taskforce should be on the question of whether both the functional and the transactional tests should be preserved. Subsidiary questions would include whether the taskforce wants to have only a transactional test, whether the current UDITPA statute permits both the transactional and functional tests and whether a change in the statute should be recommended. Anyone with an alternative approach (using neither a transactional nor a functional test but some other test) was encouraged to prepare written comments that the taskforce could address at the Whitefish conference.

In preparation for the first teleconference, it was suggested that the members review the relevant portions of the UDITPA statute and draft regulations and also re-read *Allied-Signal*. Some effort might also be made to discover if there are any important state opinions applying *Allied-Signal*.

Discussion of Topic #6

Taskforce A reached consensus that only one test should be used in determining whether a unitary business exists. Because of this consensus, further discussion of Topic #6 in the planned teleconferences is unnecessary.

Members noted that various aspects of the test might be given more or less weight depending on the nature of the corporate group under scrutiny. This perspective is already reflected, however, in the regulations.

Some members from the business side felt that the taskforce should consider whether states should allow a small or medium-sized corporation with two unitary businesses to elect in some circumstances to report their income from those businesses on a combined basis. The purpose of the election would be to simplify reporting. To minimize potential abuses, the election would have to be binding for some extended period, such as five or ten years. Some members from the state side expressed concerns about such an election. One member noted that proposed legislation in California would allow such an election not only for a single corporation but also for a corporate group. It was not clear whether consideration of such an election was within the scope of topic #6.